# Testimony of
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## On Behalf of the
# SWEETENER USERS ASSOCIATION

### Senate Committee on Agriculture, Nutrition, and Forestry
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Mr. Chairman, thank you for the opportunity to testify at this oversight hearing on the U.S. sugar program. My name is Joe Goehring, and I am the Director of Commodity Operations for The Hershey Company. I am testifying today in my capacity as a past chairman of the Sweetener Users Association. SUA members are the companies who use nutritive sweeteners in their confectionery, bakery, cereal, beverage, dairy product and food manufacturing operations, as well as trade associations representing those same industries.

**Sugar Users' Goals**

As sugar users, we want and need strong and healthy domestic sugar production and processing. We believe it is in our interest to have a geographically diverse production base in the United States for both sugar beets and sugar cane. Likewise, we believe there is a need for a strong, independent U.S. cane refining industry.

We see some real problems in the design of current U.S. sugar policy, and I will mention some of those in my testimony. But that does not mean we advocate that the United States eliminate its sugar policy entirely. Instead, we should come together as an industry – growers, processors, refiners and users alike – to arrive at a consensus on the best government policy to meet everyone's needs and serve the public interest. Our organization has proposed exactly that to our friends in the producer and processor community, and we hope they will agree that such an exercise would be constructive.

Today's hearing is especially important in helping the Committee and the public consider some of the challenges facing the current sugar program and why we believe that consideration should be given to a broad range of new policy options. First, I will point out differences between the sugar program and other agricultural support policies. I will also examine some of the limitations of the current sugar program in both design and administration. Next, I will identify some of the long-term consequences of past and current sugar policies. Finally, I will point out future challenges and provide some recommended principles which we believe should help to guide future sugar policy.

## Differences from Other Agricultural Programs

Compared to government support policies for other commodities, the sugar program is different in several respects. Two of the most important are import quotas and marketing allotments, both of which affect the availability of supplies to the marketplace, as well as who decides which supplies will be made available, and when, to the market.

Sugar is one of the few U.S. commodities whose domestic program relies on import quotas as an integral part of the support structure. Current sugar policy employs a tariff rate quota (TRQ) to limit supplies and ensure that the domestic loan program does not result in sugar forfeitures to the government. The past 25 years have shown that this policy tool, despite the best efforts of USDA, is virtually impossible to administer efficiently and effectively and has often resulted in market dislocations and sugar forfeitures to the government.

In addition to import quotas, sugar is now virtually alone among U.S. commodities in employing marketing allotments - a mandatory supply management program. Most other program crops had acreage controls until the mid-1990s, but policies were changed in the 1996 and 2002 farm bills to meet the challenges of an evolving marketplace and the realities of international trade, including the Uruguay Round Agreement and the North American Free Trade Agreement. Conversely, the last farm bill took a step backward by re-introducing marketing allotments as a foundation for sugar policy, contributing to market dislocations and administrative difficulties for USDA. Sugar is the only major commodity for which the government attempts to actively manage supplies.

The use of these tools in past and current sugar policy has had negative consequences for the entire sugar industry. I will cite several examples, but what they have in common is that the government interjects itself into the marketplace, and that often causes problems for some or all stakeholders. More important, we believe that an overhaul of sugar policy is required to avoid greater problems in the future.

## Import Quotas

One of the government's primary supply-control tools is the tariff rate quota (TRQ). During the past quarter of a century, USDA has used this tool in an attempt to balance the conflicting goals of maintaining adequate domestic sugar supplies and avoiding forfeitures.

We believe that it is difficult if not impossible for USDA (or anyone else) to accurately forecast market fundamentals, including the effects of nature, trade agreements and consumer trends, to name just a few. It is also our belief that the TRQ supply-control tool has been and will become increasingly ineffective, as the pace of change in the world increases and our multilateral and bilateral commitments expand. We believe that a more market-oriented approach will best serve future sugar policy needs.

Two specific examples of the TRQ's limitations as a policy tool were apparent in recent months after USDA announced several TRQ increases in the wake of last summer's hurricanes. Both examples are related to market circumstances which compelled USDA to allow quota imports of large quantities of refined sugar – something that is quite unusual.

The United States is obliged by World Trade Organization (WTO) rules to import minimum amounts of both raw and refined sugar. However, refined imports are normally dwarfed by raw imports. Our WTO minimum quota is 1,117,195 metric tons for raw cane sugar, but only 22,000 metric tons for refined sugar. Importing mostly raw sugar helps maintain throughput in our nation's cane sugar refineries, and that is important because this part of the sugar industry has been shrinking for many years.

Since Hurricane Katrina idled a large New Orleans-area sugar refinery for several months, the U.S. market was short of refined sugar. That shortage was apparent from the fact that refined sugar prices rallied much more sharply than raw sugar prices. The temporary loss of that refinery reduced demand for raw sugar while tightening refined sugar supplies.

USDA announced several import quota increases for refined sugar, but these quotas were less effective in increasing refined supplies than they might have been, largely because of problems that are not of USDA's making. First, U.S. Customs and Border Protection differentiates between raw and refined sugar on the basis of polarity – a measurement of purity. For U.S. industrial users, sugar needs to be refined to a polarity of 99.8 or 99.9, but Customs considers any sugar with a polarity of 99.5 or greater to be refined sugar, and therefore eligible to fill a refined sugar quota. (This practice stems from a definition of raw sugar in the Harmonized Tariff Schedules of the United States.)

Mexico produces a sugar called *estandar* which is approximately 99.6 polarity. Some other origins, including Brazil, produce similar sugars. These sugars can be imported as refined sugar, and thus help to exhaust the available quota – but they do not immediately add any refined sugar to the U.S. market, since they require further refining in the United States before they can meet normal U.S. manufacturing standards, and be delivered to an industrial user. Thus, USDA's intentions to add refined sugar to the market have in some cases been frustrated. The actual amount of refined sugar imported under the quotas has not been as great as the quota amount.

It is difficult enough to conduct business under challenging market conditions and an intrusive regulatory system. It is even more difficult when the regulation fails to match up to commercial realities. Simply put, the government considers all sugar above 99.5 polarity to be refined, but the U.S. market does not. This inconsistency should be fixed.

Another example of a TRQ problem concerns the type of quota that has been used for refined sugar. A portion of the quotas has been "first-come, first-served," meaning it is open to all origins, but if early-arriving cargoes fill the quotas, then sugar that has not yet arrived may be charged the prohibitive over-quota duty if it is imported, since it will not enter under the TRQ.

There are numerous benefits to a first-come, first-served system, but there are also disadvantages. Such a system strongly favors Canada and Mexico as origins, because the goods can enter U.S. customs territory more quickly than products that must be shipped longer distances. If there are quality issues with the nearby sugar – and there were such issues with Mexican sugar in some cases – then extra costs get built into the system, reflecting the additional steps that must be taken by industrial users before the sugar is really usable.

Again, we cite these examples to show the problems and limitations of the TRQ as a policy tool. If sugar policies were modified so as to make the TRQ unnecessary or less important we believe that these particular problems would have been addressed more efficiently and effectively, because sellers and buyers would simply source the sugar from other origins. A quota system, by definition, arbitrarily limits sellers', processors' and users' choices.

## Marketing Allotments

The government's other primary supply-control tool is marketing allotments. USDA uses this policy tool in an attempt to balance the conflicting goals of limiting domestic production, maintaining an adequate balance of domestic beet and cane sugar supplies, meeting minimum import requirements under international trade agreements, and avoiding forfeitures.

Marketing allotments were part of the 1990 farm bill, but were little used. More recently, the principal policy change for sugar in the 2002 farm bill was the re-introduction of marketing allotments. Once again, despite USDA's best efforts, the use of marketing allotments has resulted in several instances of market distortions such as volatile prices, production limitations and supply shortfalls.

USDA first established an Overall Allotment Quantity (OAQ) before the 2002/03 marketing year, and the Department's initial announcement was more conservative – that is, smaller – than the market expected. A sharp run-up in prices was the result. Subsequently, market conditions caused USDA to increase the OAQ, and prices fell.

Such price spikes and sharp declines, caused not by supply-demand fundamentals but by unexpected government action, are not a desirable result of program operations.

In subsequent years, USDA has generally done a good job of setting the OAQ and making adjustments. However, the process by which the OAQ is established remains somewhat opaque. The Department has often operated as if it had a rough stocks target in mind when making its OAQ decisions, but has never said so explicitly. As a result, the market has to try and outguess the government. Market participants must forecast not only what the government will do, but also when the action will take place. As a result, government decisions can have as much impact on the market as planting patterns, weather events or shifts in demand. That is not the case for most other agricultural commodities today, and I would suggest to you that it is not desirable from the standpoint of public policy.

More recently, the shortcomings of this policy tool have become especially obvious. Since last September, sugar markets have been dominated by the aftermath of Hurricanes Katrina and Rita (as well as Hurricane Wilma a little later). Spot prices for refined sugar cited by *Milling & Baking News* reached 50¢ per pound and even higher in a few cases, compared to a more normal range of 22-28¢ per pound. (They are still much higher than during previous periods, according to this publication, which USDA uses as its official price source since there is no futures market for refined sugar.)

Yet even in such an extreme market situation, there were still limited domestic stocks of perfectly good sugar that sellers were willing to sell, and buyers were willing to buy, that were "blocked" from the marketplace because of the allotment system. Buyer and seller could not come together to consummate a business transaction that was in their mutual interest until they got permission from the government. The result was to exacerbate the already-severe logistical problems – which beset sellers and buyers alike – and further limit the availability of sugar to the marketplace.

Something is wrong with a program that produces that kind of result. Eventually, USDA did act to permit the marketing of the "blocked" sugar. And indeed, Mr. Chairman, SUA would like to commend the Department for the multiple actions it took last fall to try and restore balance to the market. The Department paid attention to the sugar market's needs and acted promptly.

As we pointed out earlier, the use of marketing allotments as a policy tool creates market distortions and it is virtually impossible for USDA to manage such a program effectively and efficiently. Even at its best, government usually cannot react as quickly as the marketplace demands, especially in turbulent times when all buyers and sellers are scrambling to match up available supplies with pressing demands. In that kind of environment, it is problematic to have a policy which says it is illegal to sell sugar until the government decides otherwise.

I do not want to leave the impression that our concerns about the sugar program relate solely to the aftermath of last year's hurricanes. After all, no government program can control the weather. In fact, though, the program has not performed well even in calmer markets. More often than not, this sugar program has been associated with surplus domestic production, not shortage. Chronic surplus domestic production should no more be a policy goal than persistent shortage, and a program that tends to produce one or the other stands in need of change.

We have identified several shortcomings of current sugar policy, but there are also positive aspects. Three examples may be of interest to the Committee. First, the re-export programs for refined sugar and sugar-containing products have generally worked well; they supply additional throughput for cane refiners, and permit food manufacturers to be competitive in export markets.

Current policy delivers program benefits through processors rather than directly to producers as is the case for most other supported crops. This system reflects both the agronomic characteristics of sugarcane and sugar beets -- which are not storable for long periods in their unprocessed form -- but also the cooperative structure of most U.S. processing. This delivery system may well continue to be appropriate even if the support program itself undergoes changes.

Third, although SUA is generally opposed to marketing allotments, the requirement to reassign shortfalls in the cane allotment to imports is a positive feature in the current environment where allotments are legally required. The reassignment requirement, which has been used by USDA several times in recent years, helps to assure throughput for the cane refining sector even when domestic sugarcane production is lower than expected.

**Long Term Consequences – Unsustainable Future**

Mr. Chairman, we believe that there are even more compelling reasons to revise current sugar policy. These reasons include the long-term consequences of over a quarter of a century of ill advised sugar policy. We also believe that current sugar policy is unsustainable, and the sooner we can begin to talk about workable alternatives, the better for everyone, including users, refiners, processors and producers alike. Let me review just a few examples:

*Use of Domestic Sugar is Flat.* The reasons are straightforward and go far beyond the often-cited Atkins Diet, a factor which has recently faded. Price support policies kept domestic sugar priced substantially above alternative sweeteners, which took over entire demand segments. At the same time, the differential between domestic and world sugar prices created an incentive to import sugar-containing products that were not (and under WTO rules could not be) subject to import quotas. Close to a tenth of domestic sugar demand is now being filled by these products.

*Loss of U.S. Manufacturing Jobs.* High domestic sugar prices provide an added incentive to relocate U.S. food processing jobs overseas. I should note that several factors are used to determine whether or not to relocate manufacturing overseas, including labor and foreign exchange rates. However, the prospect of lower sugar input costs provides an additional powerful incentive to relocate food processing overseas. The past decade has seen several examples of the migration of food manufacturing jobs to overseas locations – and as the Commerce Department stated in a recent report, there has been a sharp difference in job growth within the food industry, with those segments that use sugar losing jobs while non-sugar-using segments experienced modest job growth.

*International Trade.* The current sugar policies of the United States are difficult to reconcile with the future direction of international trade policy, and our own trade liberalization objectives and obligations. We believe future sugar policy should be redesigned to be more closely aligned with the realities of world trade rules while still protecting producer incomes and promoting greater market orientation.

For example, in 2008 sugar trade with Mexico will be unrestricted. Mexican sugar producers are not subject to marketing allotments. Will U.S. producers be locked into a declining share of their own market? Meanwhile, any eventual Doha Round agreement is likely to require both an expansion of the sugar TRQ, and reductions in "amber box" subsidies – and today's U.S. sugar program is entirely "amber."

And while our policies ought to aim at securing the U.S. demand base for domestically produced sugar, the current program has led to approximately 10% of domestic demand being filled by sugar contained in imported products that were manufactured with world-price sugar.

**Principles to Guide Future Sugar Policy**

Mr. Chairman, the problems we have identified in current sugar policy can also lead to principles that Congress should consider in shaping sugar policy for the next Farm Bill.

The current program interposes the government among all industry stakeholders through the tariff-rate quota and marketing allotments. Future policies should aim at less government interference in normal business transactions.

For the past quarter of a century, sugar policy has not been sufficiently responsive to market signals and changes in the world economy. This has resulted in unintended consequences such as supply shortages, loan forfeitures, slow growth of domestic sugar consumption, inhibition of international trade, and the relocation of U.S. manufacturing jobs overseas. Future policies should feature greater market orientation, which will address these problems, while still recognizing producers' need for an economic safety net.

Perhaps most importantly, the current sugar policies of the United States are difficult to reconcile with a rapidly changing world and the future direction of international trade policy, and our own farm and industrial trade objectives. We believe future policies should be redesigned to be more closely aligned with the realities of world trade rules while still protecting producer incomes and promoting greater market orientation.

Mr. Chairman, we know that there will be future opportunities to make detailed recommendations for the next farm bill. We will not attempt to do so now. We prefer to work for the development of an industry consensus of growers, processors, cane refiners and users which would provide the optimum policy solution for all stakeholders going forward.

We believe change is coming, and that all of us – farmers, processors, refiners and ourselves – would be well advised to work together toward a sustainable policy that will meet the needs of all stakeholders alike. We believe those goals are also shared by this Committee, and look forward to working with you as you develop the next Farm Bill.

We thank you for this opportunity.